

**CONFIDENTIAL**

TO: Dr. William T. Butler  
FROM: Dr. Michael E. DeBakey  
DATE: August 6, 1992  
RE: Financial Overview of the Department of Surgery for the  
Finance Committee of the Board of Trustees

As you know, in early February I engaged Kenneth W. Bradshaw, who has substantial administrative, financial, and general management experience, to critique the administrative and financial aspects of the Department. Mr. Bradshaw spent more than 10 weeks of full-time effort analyzing administrative and financial information, interviewing faculty and staff, and generally observing in the Department of Surgery, the essence of his report having been presented to you, Dr. Alford, and Andrew S. MacDonald of the Executive Consulting Group, on May 19, 1992.

Upon the conclusion of his assignment, I invited Mr. Bradshaw to join the Department as Executive Administrator to assist in successfully contending with today's challenges, which will undoubtedly increase with time. He joined the Department on May 18. Since his arrival, Mr. Bradshaw and I have worked together closely to ensure satisfactory interchanges about needs, agreement regarding priorities, and achievement of objectives.

We have a financial challenge that must be resolved, although we must recognize that the financial pressures we are experiencing are common throughout academic medical institutions, especially in the surgical disciplines today. Further, it will take our best efforts to continue the high level of performance and service for which this Department and College are renown.

Specifically, we are engaged in a thorough, sustained, and responsible effort in the Department of Surgery, to optimize staff and expenses, as well as to generate additional revenue from new sources. This will be a continuing quest.

Whereas much can and will be done by all of us working together, certain constraints on the Department are inseparable from, and significantly affect, what we are able to do, the time required to do it, and the extent to which it can be done. For example, most of our surgeons, and all of our major revenue-producers, can increase their incomes significantly by resigning from the Faculty. Although none of them want to do this, most of them will if reason does not prevail regarding what they are asked to contribute financially to the Department and College, and how collections are handled.

As we communicate to the surgeons the Department's needs and future requirements, they are increasingly asking what the College does for them. A satisfactory resolution of our financial situation will necessitate equitable contractions on everyone's part.

Methodist's policies also significantly constrain our ability to generate additional income from new sources. For example, Methodist will not permit us to negotiate managed-care arrangements although this is being done throughout the nation. We have had numerous inquiries and actual proposals to negotiate contracts for cardiovascular surgical care by organizations from here and abroad, but have been prevented from doing so by the inhibitive policy of the Methodist Hospital toward such financial agreements.

As you know, the Department of Surgery has always been financially self-sufficient, and has served as a major contributor to the College, as well as substantial supporter of numerous others who contribute significantly to the College's mission. Indeed, little or no financial support has been provided by the College. For example, the Department's annual contribution toward salaries, staff support, and expenses at the VA and Ben Taub Hospitals exceeds \$800,000.00 per year. Additionally, we support research efforts and numerous other activities that benefit the College. Perhaps the best way to put our financial contribution in perspective is to note that from 1950 through June 30, 1992, the Department has contributed roughly \$180 million toward the College's mission. This represents the total income from professional fees and perfusion services income, less distributions to our surgeons, all of which has been used in behalf of the College. This is in addition to other substantial fund generation: contributions by philanthropic individuals (often patients) and research grants from foundations and the National Institutes of

Health.

Now, however, changed circumstances necessitate contracting our financial support of others. A significant change, for example, is that Medicare and Medicaid have substantially reduced what they will pay us, despite no corresponding ability on our part to lower our costs to provide these services. Indeed, because of new regulations, the cost of providing these services has actually increased. Further reductions in such reimbursements are scheduled. Moreover, the reductions for our surgeons substantially exceed those for virtually all other medical disciplines. Whereas we expect to continue to be a net contributor, it is unreasonable, under present and future circumstances, for the College to expect to continue receiving a direct allocation of 10 percent of our medical service fees.

#### Sources of "Deficits"

As pointed out in the meeting on May 19, the primary reasons for our "deficiency," in addition to the aforementioned reduction in Medicare reimbursement, are:

- (1) Inadequate reimbursement for perfusion services.

Methodist has discounted our invoices since January 1989, as follows:

<u>Fiscal Year Ended</u>	<u>Discount</u>	
	<u>Amount</u> (\$M)	<u>Percent</u>
6-30-89	94	10.4
6-30-90	160	11.1
6-30-91	323	21.5
6-30-92	<u>476</u>	32.0*
Subtotal	1,053	
6-30-93 Forecast	<u>585</u>	36.0
	1,638	

\*36% commenced January 1, 1992

- (2) Incomplete collections
- (3) Sizable expenditures for - staff
  - overtime
  - medical illustrations
  - professional expenses
  - travel
- (4) Inadequate income of some surgeons to support individual staffs

### Solutions

Immediate steps taken to improve our situation include:

- Having our perfusionists absorb the duties previously performed by six intra-aortic balloon pump specialists and support staff.
- Charging standby fees for angioplasty perfusion services, which will also provide a significant contribution.
- Placing one faculty member on disability to be followed by retirement, thereby eliminating

an annual deficit of \$276,000.00.

- Discussing seriously with another faculty member his very substantial deficit.
- Submitting a new contract proposal to the VA for perfusion services, which should improve our income by \$100,000.00 for fiscal year 1992-1993.
- Requiring prior approval for medical illustrations and travel.
- Reducing other sizable expenditures, with vigorous pursuit of substantial contractions.
- Eliminating several staff and technical positions under our direct control.
- Holding preliminary conversations with a major perfusion equipment supplier regarding a viable alternative arrangement for us to supply Methodist with perfusion services. In this connection repeated efforts have been made to negotiate with Methodist Hospital some solution to this increasing financial burden on the Department (see enclosed correspondence regarding this subject), all of which have been rebuffed.

Clearly, there is more to be done, and we are pursuing other avenues diligently and responsibly. For example, we are critically reviewing all sources and uses of income. In the instance of uses, our first question is whether we still need the function -- for example, a machine shop, electronics lab, etc. If so, what is

needed, and how can it best be provided? In each of these instances, merit raise considerations have been deferred until the function can be assessed.

After we look at each source and need, we will look at each line item of income and expense.

We are in the embryonic stage of reviewing our collections, a critically important, but very sensitive, issue. We can substantially improve our collections, and on a more cost-effective basis, but we have to work through sensitivities to achieve this end. For example, forcing centralized collections, as centralized is perceived by the surgeons, might result in their mass exodus. We will accomplish our objective, but it is going to take time, tact, and reasoning.

We are reviewing automobile allowances, which will be imminently contracted.

Responsibility for our Thoracic Residency Program is being reassigned within the Department to contract expenses.

Clerical support for our three Residency programs is being centralized to contract personnel, equipment, and space.

We will review our contract for providing perfusion services at Ben Taub, with a view toward increasing our income from it.

We are also planning a Retreat for our full-time faculty, probably in September, to foster discussions about our situation, the options, and courses of action to be pursued. As we have discussed, I think you and Dr. Alford should join us. A dialogue among all of us is important, and I think it is critical that our

surgeons hear that the College will bear its equitable share of the sacrifices that have to be made, as well as that the College will assist us in ensuring we are fairly compensated for perfusion services provided to Methodist and in generating additional income from such new sources as managed-care.

The benefits of our efforts will be realized in time. Some portion was realized in fiscal 1991-1992, and a greater realization will ensue in 1992-1993. But as the year progresses, results will commensurately carry forward into fiscal 1993-1994.

As to the fiscal year just ended, financial reports from the College show a negative balance for the Department of \$1,148,000.

Clearly, the netting of our departmental accounts, as they are shown, results in a negative balance, but these balances are after \$1,727,000 has been given directly to the College as fee distributions from our surgeons' practices. Netting the two aforementioned amounts would result in a positive balance of \$579,000. This positive balance would have increased to \$1,055,000 if Methodist had not discounted our invoices for perfusion services. Also, we think the Department more correctly contributed roughly \$10 million to the College during fiscal 1991-1992. This is the total realization from professional fees and perfusion services, less distributions to the surgeons. We fully appreciate what must be done in the Department to improve our financial situation, but we also want to ensure a correct perspective that we are a substantial net contributor to the College.

Reverting to the \$1,148,000 negative balance, as it is now



reported, I have reason to believe that we will obtain a contribution of \$570,000 toward offsetting it. As to the remaining \$578,000 "shortfall," I am asking the College to tie payment to recovery of any discount for perfusion services rendered at Methodist through June 30, 1992.

Going forward, we know what needs to be done, and are in the process of doing it. I must reiterate, however, that it is going to take time and sacrifices by all of us. The value of these sacrifices will be known only as we progress in our efforts. We will, of course, keep you informed about our efforts, but the College must recognize it can no longer look to the Department for the vast contributions we have been able to make in the past. I am asking the College also to acknowledge that circumstances have changed, and that all of us will have to make sacrifices.

In addition to the foregoing, we are mindful of such fundamental questions as the significance of losing one of our major producers, and there are a host of other fundamental questions that we will address in time.

In conclusion, while the challenges are formidable, I am encouraged, because working together we are equal to them.

Inasmuch as we have not seen a revision of the Executive Consulting Group's Draft Report, it is also appropriate to iterate here the concerns we expressed in the May 19 meeting with you, Dr. Alford, and Mr. MacDonald about certain items in that Report. Specifically:

On page 3, in the second indented paragraph, that begins "During 1989," it is important to note that the College has never been a financial contributor to the Department. Quite to the contrary, the Department has contributed more than \$180 million dollars in furtherance of the College's mission since 1950. The \$5.5 million contribution to fund "shortfalls in medical service fees" was simply a recognition by the College that it had been asking more from the Department than could reasonably be expected, with a portion of the excess requirement being reversed. This is equally applicable to the \$3.3 million that the College continues to carry as a receivable from the Department, and is not in any way as described on page 3 in the first full paragraph, which begins "Exhibit II."

Also on page 3, in the last sentence of the "Exhibit II" paragraph, it is not that we are experiencing difficulty in collecting; Methodist simply refuses to pay.

The "potentially recurring deficits" noted on page 4 in numbered paragraph 3 are being addressed, as noted previously in this memorandum.

On page 5, numbered paragraph 3, Analysis of Available Funds to Support Deficits, obviously there are restrictions on the use of Grants, Contracts, and Private Fund Accounts entrusted to the Department.

It is premature to develop a five-year plan, as recommended on page 6 in the second paragraph. We must

concentrate at the present on fiscal 1992-1993.

On page 10, paragraph A, Experimental Biology has been phased out. As to the Ben Taub Chief of Staff, this should be a Hospital District expense, and not an expense for the Department.

The comments on page 10 in paragraph B, Surgery General Budget, convey the grossly erroneous impression that the fund allocation was increased to fund certain individuals. The Scientific Communications function existed years before the referenced increase in the Surgery General Budget.

On page 9, in paragraph D, the Department can no longer afford to subsidize expenses that are rightfully the Hospital District's.

On page 12, paragraph B is incomplete, misleading, and more confusing than enlightening. The paragraph itself does not serve a useful purpose, but if it is to remain, it should be totally rewritten.

On page 14, the first full paragraph is poorly worded and incomplete, and presents an erroneous impression that there is a "great big fund out there" which is available to the Department. We are not aware of any General University Fund.

We are confused about Exhibit XXXV. First, it implies Hospital contracts accrue to the Department, whereas we believe that they are for the benefit of the College, and secondly, we are not sure who is included in the Faculty

Salaries.

Bill, these are our thoughts, and I look forward to a discussion with you and the Finance Committee about them.

KWB-loc